IN THE

# Supreme Court of the United States

OCTOBER TERM, 1943

NO. 964

FIRST NATIONAL BANK IN WEST UNION, WEST VIRGINIA, a Corporation, Petitioner,

v.

AMERICAN SURETY COMPANY OF NEW YORK, a Corporation, Respondent.

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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## PETITION FOR WRIT OF CERTIORARI.

*To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:*

Petitioner, *First National Bank in West Union, West Virginia,* a national banking association, respectfully represents that it is aggrieved by the judgment of the United States Circuit Court of Appeals for the Fourth Circuit, rendered on the 9th day of March, 1944, in an action prosecuted by Respondent, *American Surety Company of New York,* a corporation, against Petitioner, insofar as and to the extent that the judgment of the Court of Appeals reversed the judgment theretofore rendered in favor of Petitioner by the United States District Court for the Northern District of West Virginia. The portion of the judgment of the Court of Appeals herein complained of allowed a recovery by Respondent

against Petitioner to the extent of $4,050.00 (R. 337), representing bankruptcy funds deposited with Petitioner by the Trustee of a bankrupt's estate and later misappropriated by the Trustee. Respondent was surety on the Trustee's bond.

Petitioner respectfully prays for the allowance of a writ of certiorari directed to the United States Circuit Court of Appeals for the Fourth Circuit, in order that the portion of its said judgment of March 9, 1944, adverse to Petitioner, may be reviewed by your Honorable Court.

In the interest of brevity, Petitioner's supporting brief is combined herein with, and as a part of, the Petition.

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## OPINIONS BELOW.

The opinion of the Circuit Court of Appeals for the Fourth Circuit, not yet officially reported, is printed at pages 324 to 337 of the Record herein. The opinion of the District Court of the United States for the Northern District of West Virginia is reported in 50 Fed. Sup. 180 (1943), and is printed in the Record (R. 74-93).

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## JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on March 9, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended, being Section 347 of Title 28, USCA.

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## THE QUESTION PRESENTED.

The question which was decided adversely to Petitioner by the Circuit Court of Appeals, and which is of national significance and importance beyond the present case, may be stated as follows:

> *Whether a bank, which has not been designated as a depository for bankruptcy funds under Section 61 of the Bankruptcy Act, becomes a trustee ex maleficio of bankruptcy funds deposited by the Trustee of a bankrupt's estate in the ordinary course of business in a general account in the bank in which he regularly deposited both personal and trust funds, and the bank thereby automatically becomes liable to the bankrupt's estate for subsequent misappropriations of such funds by the Trustee, even though the bank admittedly had no knowledge of any misapplication or intended misapplication of the funds by the Trustee, received no benefit from the transaction, and was not conscious of any impropriety in accepting such deposit.*

## STATEMENT OF THE MATTER INVOLVED.

This was an action prosecuted in the District Court of the United States for the Northern District of West Virginia by Respondent, American Surety Company of New York, against Petitioner, First National Bank in West Union, West Virginia (hereinafter referred to as "Bank"), to recover the sum of $4,843.62, with accrued interest, representing bankruptcy funds deposited in his personal account in the Bank by one Clyde C. Ware, Trustee of the estate of Eli Nutter, bankrupt, and later misappropriated by the Trustee. Respondent was surety upon the Trustee's bond. After the defalcations were discovered, and Ware had been removed as Trustee, Respondent paid the loss to the successor Trustee of the bankrupt's estate, and obtained an assignment of subrogation rights. This assignment was obtained by Respondent on April 26, 1938 (R. 62), but the present action against the Bank was not instituted until more than four years later, on August 22, 1942 (R. 2).

Respondent invoked the jurisdiction of the District Court on the ground of diversity of citizenship (R. 2), and sought to recover against the Bank because of the following transactions had by the Trustee in bankruptcy with Petitioner:

(1) The Trustee deposited eight checks, representing $4,050.00 of bankruptcy funds, in a general account which he carried in the Bank and in which he deposited both personal and trust funds, and later withdrew the bankruptcy funds by checks drawn against said account and misappropriated them. Petitioner was not a designated depository for bankruptcy funds, and never had been.

(2) The Bank cashed for the Trustee checks aggregating the sum of $793.62, which were payable to him in his capacity as Trustee of the bankrupt's estate. The proceeds of the checks were misappropriated by the Trustee.

The Bank admittedly had no knowledge of misapplication or intended misapplication of any of these funds by the Trustee. The Trustee was not indebted to the Bank, and Petitioner received no benefit or profit from the transactions. Ware was a regular and respected customer of the Bank, which was located in the small county seat town where he resided, and in a rural community where there was no designated depository for bankruptcy funds in the entire county. The District Court, applying the established law of West Virginia to these transactions, held that there was no liability on the part of the Bank, and entered judgment in favor of Petitioner. The Circuit Court of Appeals affirmed the District Court in its holding that the Bank was not liable for the item of $793.62, covering checks payable to the Trustee which were cashed by the Bank, but reversed the District Court upon the item of $4,050.00, representing the amount of checks for bankruptcy funds deposited by the Trustee in the Bank.

The facts which give rise to the important question here presented are wholly undisputed, and may be briefly stated.

1. On or about October 10, 1934, Clyde C. Ware became Trustee of the estate of Eli Nutter, bankrupt, in bankruptcy proceedings had in the District Court of the United States for the Northern District of West Virginia (R. 58). Ware resided in the town of West Union, the county seat of Doddridge County, West Virginia.

The town has a population of approximately 1500 people (R. 75). It is a rural community.

2. Respondent, American Surety Company of New York, was surety on the Trustee's bond for $5,000.00, furnished in the bankruptcy proceeding (R. 58).

3. Petitioner is a small country bank. At the time of the transactions in question, it had about 2500 active accounts of depositors, on which about 500 checks were drawn daily; and had four regular employees, consisting of a cashier, assistant cashier, and two bookkeepers (R. 75). There were only two banking institutions in the town, of which Petitioner was one; and neither of them was a designated depository for bankruptcy funds (R. 75). In fact, there was no such designated depository in all of Doddridge County, the nearest one being located at Clarksburg, approximately thirty miles away.

4. On or about August 27, 1937, Ware received eight checks or drafts, aggregating $4,050.00, from Pittsburgh and West Virginia Gas Company, covering gas rentals due the bankrupt's estate (R. 59). The checks were drawn upon a bank at Pittsburgh, Pennsylvania, and were all made payable to the order of "Clyde C. Ware, Trustee in Bankruptcy of Eli Nutter, Stuart Building, West Union, W. Va." (R. 59). Ware endorsed each of the eight checks in blank "Clyde C. Ware, Trustee in bankruptcy of Eli Nutter", and deposited them in the Bank in a general account which he had maintained there for a number of years (R. 60). Ware kept only this one general account in the Bank, in which he deposited fiduciary and trust funds, as well as his personal funds (R. 164-5). The proceeds of the checks were credited by the Bank to this account, subject to

their ultimate payment (R. 60). The checks were paid by the Pittsburgh bank in the usual course of business, and between August 27 and December 6, 1937, the proceeds, amounting to $4,050.00, were withdrawn by Ware upon personal checks and misappropriated (R. 60). None of the checks were countersigned by a referee in bankruptcy or other officer of the bankruptcy court (R. 60-1).

5. Between August 31, 1937, and December 1, 1937, Ware received ten additional checks, aggregating $600.00, from Pittsburgh and West Virginia Gas Company, drawn upon a bank at Pittsburgh, Pennsylvania, and all made payable to "Clyde C. Ware, Trustee in Bankruptcy of Eli Nutter, Stuart Building, West Union, W. Va." (R. 65). After endorsing these checks in blank "Clyde C. Ware, Trustee in bankruptcy of Eli Nutter", Ware presented them to the Bank and received cash therefor (R. 66). During the same period, Ware received two other checks, aggregating $193.62, from Hope Natural Gas Company, drawn upon a bank at Pittsburgh, Pennsylvania, and payable to the order of "Clyde C. Ware, Trustee, West Union, W. Va."; and after endorsing both these checks in blank "Clyde C. Ware, Trustee", they were also cashed by the Bank (R. 66-7).

6. At the time of these transactions between Ware and the Bank in 1937, Ware was a leading and respected attorney in the town of West Union, enjoying probably the largest law practice in the entire county (R. 172, 193, 195). He was President of the Kiwanis Club at West Union (R. 160-1, 193), and was generally highly regarded in the community. He represented the Home Owners Loan Corporation in Doddridge County, and handled the checks covering its loans (R. 161). The

Bank had no reason to suspect any misappropriation by Ware of bankruptcy funds, nor did it receive any benefit from the transactions. In this connection, the District Court made the following Findings of Fact:

> "5. No part of the proceeds of any of the checks involved in this action, or any other assets of the bankruptcy estate were used to pay overdrafts or other personal obligations of Ware to the defendant bank. The bank did not profit or receive any benefit from the manner in which Ware negotiated and applied the proceeds of these checks, other than that incident to the relationship between bank and depositor.
>
> 6. Neither the bank, nor any employe or officer thereof had notice or knowledge that Ware was wrongfully or illegally applying the proceeds or commercial values of such checks to his personal use.
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> 7. The bank did not have notice sufficient to put it on inquiry that the proceeds of such checks, or any part thereof, were being wrongfully withdrawn by Ware, and was guilty of no negligence.
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> * * * * * * *
>
> 9. Defendant and its officers and employes, presumed and believed Ware to be honest and that he would properly and lawfully apply the funds deposited.
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> 10. The bank did not itself misappropriate or actually participate in the misappropriation of any of said trust funds." (R. 90-1).

The Court of Appeals agreed that the Bank had no knowledge of the misappropriations, saying:

> "We find no evidence of knowledge on the part of the Bank of any misappropriation of funds by the

Trustee, except such as was involved in the deposit of bankruptcy funds in his private account in a Bank which was not an authorized depository" (R. 335).

The cashier of the Bank knew, of course, that Petitioner was not a designated depository for bankruptcy funds, and he testified that the checks deposited by Ware "would indicate that they were bankruptcy funds" (R. 139). However, the cashier had no reason to believe it would be improper for the Bank to accept the deposit. He testified:

"* * * I didn't know whether they were required to be passed through the trustee, or whether he had, some of these particular checks were to be handled from, some other way, in some other way. He was one of our leading attorneys there, and I took it for granted that he knew what he was doing. He had always been very responsible." (R. 139).

In its opinion, the Court of Appeals concedes the cashier's innocence, but says he was mistaken as to the legal consequences of the acceptance of the deposit:

"He (the cashier) testified that he thought that the restrictions did not prevent the acceptance by an unauthorized bank of bankruptcy funds provided they were deposited by the Trustee to his personal account. He evidently overlooked the inherent breach of trust involved in such a deposit by the trustee". (R. 328).

7. On December 6, 1937, an order was entered in the bankruptcy proceeding, directing Ware to make distribution of the bankruptcy funds (R. 61). Thereafter, upon the discovery that he had misappropriated funds,

Ware was removed as Trustee, and a new Trustee was elected in his stead on or about February 28, 1938 (R. 61). On March 30, 1938, the successor Trustee made claim against Respondent, as surety on Ware's bond, and on April 26, 1938, the referee entered an order adjudging Respondent to be liable for $5,000.00, the face amount of its bond (R. 61-2).

8. On April 26, 1938, Respondent paid to the successor Trustee the sum of $5,000.00 in settlement of its liability on Ware's bond, and received in return a subrogation assignment (R. 62-4). More than four years later, on August 22, 1942, Respondent instituted this action against Petitioner in the District Court (R. 2).

9. The case was heard before the District Court without a jury upon an agreed statement of facts, supplemented by some oral testimony. The District Court held, in a written opinion (R. 74-89), with appropriate Findings of Fact and Conclusions of Law (R. 89-93), that there was no liability on the part of the Bank. The District Court's Conclusions of Law included the following:

> "1. Not being a designated depository of bankruptcy funds, the defendant bank was not subject to the laws and statutes and General Orders in Bankruptcy relating to such depositories.
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> 2. Defendant's alleged liability must be tested by the law of West Virginia. *Erie R. Co. v. Tompkins,* 304 U. S. 64; *Metropolitan Life Ins. Co. v. Goodwin,* 4 Cir., 92 F. (2d) 274.
>
> 3. The law in West Virginia on this subject is as follows: To render a bank of deposit liable for the default or misappropriation by a fiduciary of a

trust fund deposited it must have actually participated therein, or with knowledge reaped some benefit therefrom, as by itself. Appropriating the money or receiving it in payment of some individual indebtedness of the fiduciary to it and thereby rendering itself liable as trustee or otherwise. *United States Fidelity and Guaranty Co. v. Home Bank,* 77 W. Va. 665, 88 S. E. 109; *United States Fidelity & Guaranty Co. v. Hood* (1940), 122 W. Va. 157." (R. 91).

10. Upon appeal, the Circuit Court of Appeals affirmed the judgment of the District Court, insofar as the District Court absolved the Bank of any liability for the item of $793.62, covering checks which the Trustee cashed at the Bank, the Court of Appeals saying:

> "We find no evidence of knowledge on the part of the bank of any misapplication of funds by the Trustee except such as was involved in the deposit of bankruptcy funds in his private account in a bank which was not an authorized depository; and this is not sufficient, we think, to charge the bank with notice of intended misapplication of the proceeds of checks which he collected in cash." (R. 335).

However, the Court of Appeals reversed the District Court's judgment "in so far as it relates to liability for the checks aggregating $4,050.00, which it received for deposit and credited to the personal account of the Trustee" (R. 335-6).

Conceding that the Bank had no knowledge whatsoever of any misapplication of funds by the Trustee, the Court of Appeals based its reversal as to the $4,050.00 item upon this very narrow ground: that as

the Bank was not a designated depository for bankruptcy funds, as contemplated by Section 61 of the Bankruptcy Act, the mere deposit of the checks aggregating $4,050.00 in the Bank by the Trustee in his personal account imposed absolute liability upon the Bank, as a trustee *ex maleficio,* when the Trustee later misappropriated these funds. The Court of Appeals said:

> "The deposit itself constituted a breach of trust on the part of the trustee * * * and upon the receipt of the deposit under such circumstances, the bank became a trustee ex maleficio of the amount so received and liable therefor as a trustee to the estate of the bankrupt" (R. 326).
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> "A deposit of bankruptcy funds in an unauthorized depository gives rise to a constructive trust, or a trust ex maleficio" (R. 329).
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> "The liability of the bank with respect to the deposit is that of a constructive trustee, or trustee ex maleficio, for the bankrupt estate. As the funds involved in the deposit have not been returned to the estate, the bank is liable therefor to the estate, or to plaintiff as assignee of the rights of the estate." (R. 334).

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## BANKRUPTCY STATUTES AND GENERAL ORDERS INVOLVED; THE CHARACTER OF BANKRUPTCY FUNDS.

Before stating the grounds relied upon by Petitioner for certiorari, it seems advisable to call attention to the two sections of the Bankruptcy Act, and to the General Order in Bankruptcy, upon which the Court of Appeals predicated its ruling adverse to Petitioner. Section 61 of the Bankruptcy Act, 11 USCA 101, provides:

> "61. Courts of bankruptcy shall designate, by order, banking institutions as depositories for the money of the bankrupt estates, as convenient as may be to the residences of trustees, and shall require bonds to the United States, subject to their approval, to be given by such banking institutions, and may from time to time as occasion may require, by like order increase the number of depositories or the amount of any bond or change such depositories; Provided, That no security in form of a bond or otherwise shall be required in the case of such part of the deposits as are insured under section 264 of Title 12."

Section 47 of the Act*, 11 USCA 75, relating to the duties of Trustees in Bankruptcy, includes the following provisions:

> "Trustees shall * * * (2) Deposit all money received by them in designated depositories. * * *

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* Section 47 of the Bankruptcy Act, being of some length, is set forth in its entirety in the Appendix to this petition.

(4) Disburse money only by check or draft on such depositories."

General Order in Bankruptcy No. 29, promulgated by this Court, is as follows:

"29. No moneys deposited as required by the Act shall be drawn from the depository unless by check or draft, signed by the clerk of the court or by a receiver or trustee, and countersigned by the judge, or by a referee, or by the clerk or his assistant under an order made by the judge, stating the date, the sum, and the account for which it is drawn. An entry of the substance of each check or draft, with the date thereof, the sum drawn for, and the account for which it is drawn, shall be forthwith made in a book kept for that purpose by the receiver or trustee; and all checks and drafts shall be entered in the order of time in which they are drawn, and shall be numbered in the case of each estate. A copy of this general order shall be furnished to the depository, and also the name of any clerk authorized to countersign said checks."

It was solely upon the framework of the two foregoing sections of the Bankruptcy Act, and of General Order No. 29, that the Court of Appeals based its conclusion that an undesignated banking institution's acceptance of a deposit of bankruptcy funds, even in a rural community where there were no designated depositories, would subject the Bank to *absolute liability* for the Trustee's defalcations, though there was no knowledge on the Bank's part that the Trustee was engaged in misappropriating funds. With all deference, we submit that the Court of Appeals read into the Bank-

ruptcy Act something which is not there. The question here is not what may have been the duty of the Trustee in depositing the checks; *the question is what responsibility the Bank incurred when it innocently accepted the deposit.* Sections 61 and 47 of the Act do not say that the acceptance of a deposit of bankruptcy funds by an undesignated bank constitutes an illegal act or breach of trust on its part.

This was aptly pointed out by the Supreme Court of Minnesota in *Rodgers v. Bankers National Bank,* 179 Minn. 197, 229 N.W. 90 (1930), where the Court said, at pages 95-97 of 229 N.W.:

> "* * * The purpose of these sections of the act and the order is to safely keep the money. They are directed to the trustee and to the designated depository. They protect the creditors against weak and insolvent banks. Defendant was not a designated depository. * * * *The provisions of the Bankruptcy Act and the general order mentioned were not meant to regulate the conduct of a bank which is not a designated depository.* They were not intended to change the law applicable generally to a bank receiving fiduciary funds. Nor were they intended to define the liabilities of banks generally having business relations with trustees in bankruptcy. There is no reason or principle permitting us to extend the protective provisions beyond their special purposes. They alone furnish adequate protection to the estate. Nothing else is necessary. We should not, therefore, impose added burdens upon those who are not reasonably within their operation. *There is no reason to construe these efficient protective measures as imposing additional liabilities upon*

> *a bank which has never become a designated depository* and in which the trustee has not opened his checking account, in his name as such trustee.
>
> * * * * * * *
>
> *We are reluctant to read into the Bankruptcy Act or the General Orders an intention, nowhere expressed therein, to change the general rules governing the liabilities of banks in dealing with fiduciaries.* Laws must be construed, if reasonably possible, to facilitate business and promote the general welfare." (Italics ours)

Indeed, in the District Court, Respondent seems to have taken the same view, for in its opinion the District Court quoted the following statement from Respondent's brief:

> "It is not contended by the plaintiff that there is anything in the federal statutes, rules and orders, which, without more, imposes an absolute liability in the premises upon the defendant" (R. 88).

The situation with respect to bankruptcy funds is quite different from that pertaining to a deposit of *public funds,* for there is an express Act of Congress applicable to the latter. Section 96 of the Criminal Code, 18 USCA 182, provides as follows:

> "96. *Banker receiving unauthorized deposit of public money.* Every banker, broker or other person not an authorized depository of public moneys, who shall knowingly receive from any disbursing officer, or collector of internal revenue, or other agent of the United States, any public money on deposit, or by way of loan or accommodation, with or without interest, or otherwise than in payment of

a debt against the United States, or shall use, transfer, convert, appropriate, or apply any portion of the public money for any purpose not prescribed by law; and every president, cashier, teller, director, or other officer of any bank or banking association who shall violate any provision of this section is guilty of embezzlement of the public money so deposited, or applied, and shall be fined not more than the amount embezzled, or imprisoned not more than ten years, or both."

Thus, by Section 96, the mere acceptance of a deposit of public money by a banking institution "not an authorized depository of public moneys" is illegal and constitutes a criminal offense. But there is no such statutory prohibition applicable to bankruptcy funds, as it is settled that they are *private funds,* and not public funds. In *United States ex rel. Willoughby v. Howard,* 302 U.S. 445 (1938), at page 453, this Court said:

> "For federal public funds Congress has provided a depository system by which the moneys, as soon as deposited, are in effect in the Treasury of the United States. * * * Similar provision has been made in many states for the deposit of public funds of the state or municipality. But the funds of bankruptcy estates are private funds. * * * and the provisions in the Bankruptcy Act concerning the appointment of depositories and the deposits to be made by Trustees are of a very different character."

The highest court in West Virginia law has also held that bankruptcy funds are *private* funds: *Townshend v. Ward,* 120 W. Va. 655 (1938).

## GROUNDS RELIED ON FOR ALLOWANCE OF WRIT OF CERTIORARI.

At the threshold of this case is the question of whether the fundamental issue involved—the determination of what responsibility the Bank assumed upon acceptance of the deposit of bankruptcy funds—is to be determined under West Virginia or Federal law. The District Court applied the West Virginia law (R. 84, 91). The Court of Appeals said the Federal law controlled (R. 331). From either viewpoint, we respectfully submit that the ruling of the Court of Appeals merits a review on certiorari and falls within the recognized grounds for such review, as outlined in Section 5 of Rule 38 of this Court.

### I.

**The Court of Appeals here erroneously decided an important question of local law in direct conflict with applicable decisions of the highest West Virginia Court. It erred in not applying the West Virginia law, in accord with principles laid down by this Court in Erie Railroad Company v. Tompkins, 304 U. S. 64 (1938) and kindred cases, including the recent case of Meredith v. City of Winter Haven, 64 S. Ct. 7 (1943).**

Respondent's complaint alleged diversity of citizenship as the ground for invoking the jurisdiction of the District Court (R. 2). The mere fact that Petitioner happened to be a National Bank did not, of course, make the West Virginia law inapplicable: *Aetna Casualty and Surety Company v. Catskill National Bank,* 102 F. (2d) 527 (CCA 2, 1939). Although administered by bank-

ruptcy courts under an Act of Congress, the moneys of a bankrupt's estate are *private funds*: *United States ex rel. Willoughby v. Howard,* 302 U.S. 445 (1938). While the Bankruptcy Act provides for designated depositories, in which the Trustees are to make their deposits, there is nothing in the Act, either express or implied, that imposes the harsh penalty of absolute liability on a banking institution, not designated as a depository, which accepts a deposit of such funds in good faith and without knowledge of the Trustee's misappropriations.

The District Court said that the provisions of the Bankruptcy Act were "not designed to define the liabilities of banks generally having relations with trustees in bankruptcy" (R. 88), and held (R. 91, 84) that the case was governed by two decisions of the highest Court of West Virginia: *United States Fidelity & Guaranty Company v. Home Bank,* 77 W. Va. 665 (1916), and *United States Fidelity & Guaranty Company v. Hood,* 122 W. Va. 157 (1940). One of the cases cited by the District Court, *United States Fidelity & Guaranty Company v. Home Bank,* is a leading case on the subject*; in it the Supreme Court of Appeals of West Virginia said, at page 669 of the opinion:

> "To render a bank of deposit liable for the default or misappropriation by a fiduciary of a trust fund deposited it must have actually participated therein, or with knowledge reaped some benefit therefrom, as by itself appropriating the money or

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* The District Court said, in referring to the decision of the West Virginia Court in the *Home Bank* case:

> "This is one of the leading cases in the country upon the subject here involved, and a case which is cited with approval by most text writers." (R. 82).

receiving it in payment of some individual indebtedness of the fiduciary to it, and thereby rendering itself liable as trustee or otherwise. The mere ordinary benefits of the account of the depositor will not be sufficient to so charge it."

The rule thus adopted by the highest court of West Virginia represents the majority view in the United States: *40 Harvard Law Review,* 1077, 1080; *34 Harvard Law Review,* 454, 469; *Rodgers v. Bankers National Bank,* 179 Minn. 197, 229 N. W. 90 (1930). This view is amply supported by decisions of the federal courts:

*Empire Trust Company v. Cahan,* 274 U. S. 473 (1927);

*Atlantic Company v. Barnes,* 95 F. (2d) 273 (CCA 5, 1938);

*Aetna Casualty and Surety Company v. Catskill National Bank,* 102 F. (2d) 527 (CCA 2, 1939);

*Maryland Casualty Company v. City National Bank,* 29 F. (2d) 662 (CCA 6, 1928), cert. denied, 279 U. S. 847;

*Bank of Vass v. Arkenburgh,* 55 F. (2d) 130 (CCA 4, 1932), cert. denied, 286 U. S. 561.

The rule of non-liability adopted in the majority of jurisdictions has been carried into the Uniform Fiduciaries Act, which is in effect in a number of states: *40 Harvard Law Review,* 1085-6.

But the Fourth Circuit Court of Appeals declined to follow the two West Virginia cases cited by the District Court. The Court of Appeals said:

"We would be in accord with the conclusions reached by Court below if the only principles here

applicable were those controlling in the case of deposit and withdrawal of funds by an ordinary fiduciary, where nothing in the law forbids the deposit of trust funds in the personal account of the trustee or in the bank in which the deposit is made" (R. 326).

But, as we have pointed out before, where is there anything in the Bankruptcy Act, or elsewhere in the Federal statutes, which forbids the deposit of bankruptcy funds in an undesignated depository, and makes it illegal for such a banking institution to accept the deposit, under penalty of absolute liability for any funds so accepted?

The Court of Appeals concluded that the West Virginia law was not controlling. It said:

> "In determining the liability of a bank for a deposit of bankruptcy funds made in violation of the terms of the Bankruptcy Act, however, we do not understand that we are bound by decisions of the local courts; for the question involved is one of federal rather than local law" (R. 331).

It is respectfully submitted that in this conclusion the Court of Appeals erred, and that it should have been guided by the principles of *Erie Railroad Company v. Tompkins,* 304 U. S. 64 (1938) and kindred decisions of this Court, including the recent case of *Meredith v. City of Winter Haven,* 64 S. Ct. 7, decided November 8, 1943.

When the Court of Appeals said that the deposit here was made "in violation of the terms of the Bankruptcy Act", we submit it made a wholly unwarranted assumption, at least in so far as the legal responsibility

of the Bank was concerned. The Bankruptcy Act does not say, as does Section 96 of the Criminal Code relating to "public funds", that it was illegal or improper for Petitioner to accept the deposit, irrespective of what may have been the duty or proper practice of the Trustee in that respect.

Had the Court of Appeals applied the applicable West Virginia decisions, it must necessarily have reached the same conclusion as the District Court, for there can be no doubt as to the West Virginia law on the subject. Indeed, the West Virginia Court has passed upon a case involving a deposit of bankruptcy funds. In *Townshend v. Ward,* 120 W. Va. 655 (1938), a Trustee in bankruptcy sued the Receiver of a closed state bank in West Virginia to recover bankruptcy funds deposited by the Trustee before the bank failed. The bank had been designated as a depository by the bankruptcy court, subject to the following requirement as to the furnishing of a bond:

> "In the event the amount on deposit * * * exceeds the amount of the bond as above, the bank shall at once increase its bond to cover said excess."

The bank thereupon gave surety bonds totalling $40,000.00; but when it closed, the deposit of bankruptcy funds aggregated approximately $35,000.00 in excess of the bonds. It was claimed by the Trustee that the bankruptcy funds deposited in excess of the bonds should be treated as trust funds, on the theory that they were illegal or improperly accepted by the banking institution —the same theory which Respondent advances in the present case. The Supreme Court of Appeals of West Virginia rejected the Trustee's contention, and said, at page 659 of its opinion:

"It is not contended that the subject of this controversy consisted of deposits of government money, either federal, state, or of a subdivision of the state. The deposits of a trustee in bankruptcy are personal and general deposits. Their classification is not altered, in whole or in part, by the fact that their amount exceeds the penalty of the depository bond. This does not change their nature to that of public funds. See as bearing upon this question *United States ex rel. Willoughby v. Howard,* 302 U. S. 445, 453, 58 S. Ct. 309, 82 L. Ed. 352. * * * Cases which involve the deposit of well recognized public funds, we think, for various reasons, are not in point, an example of which is the holding in *Monongalia County Court v. Bank,* 112 W. Va. 476, 164 S. E. 659.

"The Bankruptcy Act does not require a designated depository for bankruptcy funds to refrain from accepting for deposit bankruptcy funds in an amount which exceeds the penalty of its depository bond."

Neither does the Bankruptcy Act, or any other federal statute, require an undesignated bank to refrain from accepting a deposit of bankruptcy funds, under penalty of being adjudged a trustee *ex maleficio.*

It is true the Circuit Court of Appeals intimated that even if it should apply the West Virginia law, the Bank would still be liable (R. 331); and it referred to two West Virginia cases, *Vance v. Kirk's Adm.,* 29 W. Va. 344 (1887) and *Huffman v. Hayden,* 114 W. Va. 660 (1934). But an examination of the last two cited decisions will disclose that they have absolutely no application to the present case, either on the facts involved,

or the law therein pronounced. The West Virginia decisions which are controlling are *United States Fidelity & Guaranty Company v. Home Bank,* 77 W. Va. 665 (1916), and *Townshend v. Ward,* 120 W. Va. 655 (1938).

It is respectfully submitted that the Court of Appeals erred in not treating the question here involved as a matter of local law, governed by applicable West Virginia decisions; and that upon applying the pertinent decisions of the highest court of West Virginia, the Court of Appeals must have found, as did the District Court, that there was no liability upon the Bank.

## II.

**The holding of the Court of Appeals is directly contrary to the decision of the Circuit Court of Appeals for the Seventh Circuit in In re Bogena & Williams, 76 F. (2d) 950 (1935); to the decision of the Circuit Court of Appeals for the Sixth Circuit in Irving Trust Company v. United States, 83 F. (2d) 20 (1936); and in principle to the decision of the Circuit Court of Appeals for the Fifth Circuit in Hancock County v. Hancock National Bank, 67 F. (2d) 421 (1933).**

In the present case, the Court of Appeals based its decision against Petitioner upon the theory that the deposit of bankruptcy funds in an unauthorized depository automatically gave rise to a "trust *ex maleficio*". The following quotations from the opinion of the Court of Appeals are illustrative:

> "A deposit of bankruptcy funds in an unauthorized depository gives rise to a constructive trust, or a trust ex maleficio" (R. 329).

"The liability of the bank with respect to the deposit is that of a constructive trustee, or trustee ex maleficio for the bankrupt estate" (R. 334).

Precisely the opposite conclusion has been reached in the Seventh and Sixth Circuits in cases dealing with bankruptcy deposits in unauthorized depositories.

In *In re Bogena & Williams,* 76 F. (2d) 950 (1935), a deposit had been made in an undesignated depository by the truste of a bankrupt's estate. The bank having failed, the trustee sought a preferred claim against the funds in the possession of the Receiver of the closed bank, on the theory that the acceptance by the bank of the deposit of bankruptcy funds constituted a "trust *ex maleficio*", precisely the same theory which the Fourth Circuit Court of Appeals applied against Petitioner in the present case. The Court of Appeals for the Seventh Circuit rejected the trustee's arguments, and its opinion in so doing is so pertinent here that we quote at some length from pages 952-3:

> *"We think a trust ex maleficio did not arise by reason of the old bank accepting the deposits when it was not a designated United States depository for bankruptcy funds.* A trustee in bankruptcy is vested by operation of law with the title to all the bankrupt's property, except that which is exempt. 11 USCA Sec. 110; *Mueller v. Nugent,* 184 U. S. 1, 22 S. Ct. 269, 46 L. Ed. 405. Ordinarily, when money is deposited in a designated depository bank by a trustee in bankruptcy, it is deposited as other money is, and becomes the property of the bank, leaving the bank a debtor for the amount. Gardner, Trustee, v. Chicago Title & Trust Company, 261 U. S. 453, 43 S. Ct. 424, 67 L. Ed. 741, 29 A. L. R. 622. In

Hancock County v. Hancock National Bank (C. C. A.) 67 F. (2d) 421, a bank designated as a depository for state funds accepted deposits of county funds without giving sufficient bond, as required by the statute of Georgia. It was there held that the bank acquired title to the funds deposited, and was not a trustee ex maleficio. * * *

* * * * * * *

"Appellee, in support of a contrary doctrine, relies upon In re Potell (D.C.) 53 F. (2d) 877; In re Weiss (D.C.) 2 F. Supp. 767; In re Ocean City Title & Trust Company's Bond (D.C.) 6 F. Supp. 311; Allen v. United States (C.C.A.) 285 F. 678; Board of Commissioners v. Strawn (C.C.A.) 157 F. 49; In re Battani (D.C.) 6 F. Supp. 376; Adams v. Champion (C.C.A.) 70 F. (2d) 956. In the Potell case a trustee had not yet been appointed, and that fact was somewhat stressed in the opinion. The Weiss Case was largely based upon the Potell Case, although the trustee had been appointed and had made the deposit. The court thought that made no difference, saying there might be a distinction for technical reasons, not then important, but there was no difference for present purposes. There was, however, the additional fact that the bank had unequivocally and falsely stated to the trustee at the time the deposit was made that it was a duly designated depository for bankruptcy funds, when in fact it was not. That, indeed, was sufficient to render the distinction for other reasons unimportant. In the Ocean City Case, the court held that a surety on a bond given to secure bankruptcy deposits was entitled to have the bond canceled, where the depository substituted for the depository originally

named in the bond was not an official bankruptcy depository. It was further held that the trustees in bankruptcy, in a summary proceeding, could petition the bankruptcy court to direct the receiver of the substituted depository bank to return the deposits. There was no fraud or misrepresentation on the part of the bank, and the court based its ruling on the Potell and Weiss cases. *The Allen Case had to do with public funds of the United States, and the acts complained of were in direct violation of the Criminal Code, R.S. Sec. 5497, 18 USCA Sec. 182.* The Strawn Case related to acts of a bank which were in direct violation of the Ohio statute preventing a general deposit of public funds. In the Battani Case the court refers to different decisions of the federal courts under various states of fact. It discusses the Hancock, Potell and Weiss Cases, supra, and refers to the Strawn Case, and generally to numerous other cases in which it was held that where deposits were made in violation of a prohibitory law they became funds in trust for the depository. The court then said that the deposits in question became trust funds by operation of law (11 USCA Sec. 75 (a) (3)) in case the depository bond was invalid. That question, however, was not before the court, because it held that the bond was valid and that there was no trust. The case of Adams v. Champion relied upon by appellee was reversed by the Supreme Court in a decision rendered February 4, 1935, 55 S. Ct. 399, 79 L. Ed. ...

"Wherein the cases relied upon by appellee are inconsistent with the rule laid down in the Hancock Case we are not willing to follow them. *We think*

*there should be and is a difference, so far as the liability of the bank is concerned, between the cases where the bank by mandate of law is prevented from receiving deposits, and those where a trustee is merely required to make his deposits in a certain bank.*" (Italics ours).

In *Irving Trust Company v. United States,* 83 F. (2d) 20 (1936), certiorari denied: 298 U.S. 686, a trustee of a bankrupt's estate had deposited funds in a banking institution which was not a designated depository for the particular judicial district in which the estate was being administered. The bank having failed, the trustee sought to recover the bankruptcy funds, on the theory that the acceptance of the deposit under such circumstances created a "trust *ex maleficio*". The Court of Appeals for the Sixth Circuit held* that no such trust was created upon the acceptance of the deposit by an ineligible banking institution, saying at pages 23-4 of the opinion:

> "Finally it is contended that if it be held that the Guardian Company was not an authorized depository for funds of foreign trustees and receivers, and that such trustees and receivers are not entitled to participate in the security given by it, then it should be regarded as a trustee ex maleficio, and for that reason the Irving Company should be adjudged a lien on its assets as against other credi-

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* In the earlier case of *Commercial Savings Bank and Trust Company v. National Surety Company,* 294 Fed. 261 (CCA 6, 1923), the Circuit Court of Appeals for the Sixth Circuit held, in a suit by the surety company against the Bank, that the Bank was not liable for loss of bankruptcy funds deposited by a Trustee in his personal account and later misappropriated.

tors. * * * The basis of the Irving Company's contention is that title to the funds never passed to the Guardian Company. There are cases holding that where a public officer, acting in his official capacity, makes a deposit of a public fund in his custody in a bank without authority so to do, and where the bank has no authority to receive the deposit, the title does not pass and the fund may be recovered if traced. Board of Com'rs v. Strawn, 157 F. 49, 15 L.R.A. (N.S.) 1100 (C.C.A. 6); Empire State Surety Co. v. Carroll County (C.C.A.) 194 F. 593; Allen v. United States (C.C.A.) 285 F. 678; American Surety Co. v. Jackson (C.C.A.) 24 F. (2d) 768, 769. These cases involved funds belonging to a governmental unit deposited in a bank in violation of a prohibitory statute. The theory on which they were decided, it would seem, is that when a bank is prohibited by statute from accepting a deposit, title does not pass as in the case of an ordinary deposit, and although possession passes, the right of possession remains where it was before the deposit was made—with the holder of the title, who may exercise the right when he finds the fund. The same theory has been applied by some of the District Courts to deposits by trustees of funds of bankrupt estates in banks not designated as depositories or in designated depositories which failed to give security. In re Potell, 53 F. (2d) 877 (D.C.E.D.N.Y.); In re Weiss (D.C.) 2 F. Supp. 767; In re Ocean City Title & Trust Company's Bond (D.C.) 6 F. Supp. 311; Hillsdale Grocery Co. v. Union & People's Nat. Bank (D.C.) 6 F. Supp. 773. See, also, in re Battani (D.C.) 6 F. Supp. 376, dicta to the same effect. We think it was erroneously

applied, for *the trustee takes title to the bankrupt's funds* (11 USCA Sec. 110 (a)); Isaacs v. Hobbs Tie & T. Co., 282 U.S. 734, 51 S. Ct. 270, 75 L. Ed. 645), *which are private funds.* Florida Bank & Trust Co. v. Union Indemnity Co., 55 F. (2d) 640, 641, 83 A.L.R. 1102 (C.C.A. 5). And *when the funds are deposited in a bank, the ordinary relation of creditor and debtor arises between the trustee and the Bank.* Gardner v. Chicago Title & Trust Co., 261 U.S. 453, 456, 43 S. Ct. 424, 67 L. Ed. 741, 29 A.L.R. 622. *In such case there is no trust ex maleficio."* (Italics ours)

Both the Seventh and Sixth Circuit Courts of Appeal, in their opinions above quoted, considered, and either rejected or distinguished, the five District Court decisions relating to bankruptcy deposits cited and relied upon (R. 329) by the Fourth Circuit Court of Appeals in the present case. And it is significant that the Court of Appeals for the Fourth Circuit recognizes in its opinion that there is conflict between its decision here and the foregoing decisions in the Seventh and Sixth Circuits (R. 329).

Another Circuit Court of Appeals decision conflicting in principle with the ruling of the Fourth Circuit Court of Appeals is *Hancock County v. Hancock National Bank,* 67 F. (2d) 421 (CCA 5, 1933)*.

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* In an earlier case dealing with a deposit of bankruptcy funds, *Lamb v. Townshend,* 71 F. (2d) 590, 594, (C.C.A. 4, 1934), the Court of Appeals for the Fourth Circuit cited with approval the *Hancock County* case from the Fifth Circuit; but it failed to apply the principles of that decision in the present case.

We respectfully submit that the decision of the Court of Appeals for the Fourth Circuit is in irreconcilable conflict with the decisions from the Seventh and Sixth Circuits above referred to, as to the legal effect of the acceptance of a deposit of bankruptcy funds by a bank not designated as a depository by the bankruptcy court. The question is an important one, and of frequent occurrence; and such conflict should be resolved by an authoritative decision of this Court.

## III.

**The decision of the Court of Appeals, in treating the deposit of bankruptcy funds made in Petitioner's bank on the same basis as "public funds", is in conflict with the principles of law declared by this Court in the case of United States ex rel. Willoughby v. Howard, 302 U. S. 445 (1938).**

The Court of Appeals conceded that bankruptcy funds are private and not public funds, but failed to give effect to this vital distinction. It said:

> "* * * It is true, as argued, that such funds are private and not public funds; but this is a distinction without a difference. The controlling consideration is that, just as in the case of public funds, the law requires deposit in a designated depository, that deposit elsewhere is without legal authority and that a bank receiving the deposit with notice of its trust character must hold it subject to the trust or respond in damages for failure to do so." (R. 329).

Thus, the Court of Appeals, in effect, treated the deposit of bankruptcy funds on precisely the same basis

as if it had been a deposit of Federal "public funds" made in Petitioner's bank in violation of Section 96 of the Criminal Code, hereinbefore referred to. Indeed, the Court of Appeals cited and relied upon "public fund" cases. (R. 328).

In committing what we conceive to be this fundamental error, the Court of Appeals departed from the principles laid down by this Court in *United States ex rel. Willoughby v. Howard,* 302 U.S. 445 (1938). This Court there said, at page 453:

> "The contention that the Bankruptcy Act established a depository system which relieved trustees and receivers wholly of the duty of exercising care as to the condition or stability of a depository rests upon false analogy. For federal public funds Congress has provided a depository system by which the moneys, as soon as deposited, are in effect in the Treasury of the United States. 31 U.S.C.A. Sec. 476-478, 495; 12 U.S.C.A. Sec. 391, 392. Under that system an officer who has duly made the deposits is relieved of all responsibility for the stability of the depository. Similar provision has been made in many States for the deposit of public funds of the state or municipality. *But the funds of bankruptcy estates are private funds,* see Texas & P. R. Co. v. Pottorff, 291 U.S. 245, 257, note 11, 78 L. Ed. 777, 784, 54 S. Ct. 416, and *the provisions in the Bankruptcy Act concerning the appointment of depositories and the deposits to be made by trustees are of a very different character.*" (Italics ours)

The West Virginia Court is in accord that bankruptcy funds deposited in a banking institution must be

treated solely as *private* funds: *Townshend v. Ward,* 120 W. Va. 655 (1938). And in *In re Bogena & Williams,* and *Irving Trust Company v. United States,* cited *supra,* both the Seventh and Sixth Circuit Courts of Appeals pointed out that a deposit of bankruptcy funds does not fall within the same category as a deposit of "public funds" in an unauthorized depository in violation of Section 96 of the Criminal Code.

## IV.

**The question involved is of national significance and importance beyond the present case. The harsh rule adopted by the Court of Appeals removes bankruptcy funds from the field of normal banking transactions. The question should be settled by an authoritative decision of this Court.**

The question presented here is an important one, and of rather frequent occurrence. It arises wherever a trustee in bankruptcy makes a deposit in a banking institution not designated as a depository by the bankruptcy court. In rural communities such designated depositories are not always available. There was no such depository at all in Doddridge County, West Virginia, where Petitioner's bank is located. The Trustee here made the deposit in his local bank, where he kept his personal account. The rule of absolute liability applied by the Court of Appeals to Petitioner, in the admitted absence of any knowledge on Petitioner's part that the Trustee was misappropriating bankruptcy funds, seems unduly harsh. It is applied in the absence of any federal statute making it illegal for an undesignated bank to accept such a deposit. The Court of Appeals has not cited, in support of its harsh rule, any case involving

bankruptcy deposits, aside from some District Court decisions which, as we have seen, have been criticized or repudiated by both the Seventh and Sixth Circuit Courts of Appeals.

In treating a deposit of bankruptcy funds on a different basis from a deposit of other "private funds", the Fourth Circuit Court of Appeals not only stands alone among Federal appellate courts, but it also removes bankruptcy funds from the field of ordinary banking transactions. Contrast this with what was said by the New York court in *Maryland Casualty Company v. Central Trust Company,* 39 N.Y. Sup. (2d) 293, 265 App. Div. 416 (1943), at pages 296 and 298:

> "* * * respondents further contend that in view of the fact that these were the deposit of bankruptcy estate funds, pursuant to a court order, the opening of such account created more than the ordinary debtor and creditor relationship in that the deposited funds were impressed with the trust of a quasi public nature for the benefit of a group of creditors and under the protection of acts of Congress and rules of the United States Supreme Court.
>
> The question involved on this review is whether deposits made of bankrupt estate funds are to be considered, or not to be considered, as ordinary banking transactions.
>
> * * * * * * *
>
> * * * when the Government of the United States devised a method of handling bankrupt estates for the purpose of liquidating businesses which were in financial distress, then there was no particular reason to regard the handling of such estates as other than commercial transactions governed by the

laws and rules applicable to the ordinary banking transactions. The conclusion is therefore reached that in actions brought on behalf of the depositor, or by one who stands in the shoes of the depositor, although the deposit is of bankruptcy funds, it is a suit subject to the defenses which may be pleaded in the ordinary depositor—bank suits * * *".

We think it can be said here, as was said by Mr. Justice Holmes in *Empire Trust Company v. Cahan,* 274 U.S. 473, 478 (1927):

> "The court below applied too strict a rule to an ordinary business transaction."

The rule here adopted by the Court of Appeals is particularly harsh because Respondent is not merely attempting to impress a trust upon funds in the hands of Petitioner, such as would be the case if the claim were asserted against the Receiver of a closed bank. Here, the funds are gone and the attempt is to thrust personal liability upon the Bank.

As was aptly pointed out by the Supreme Court of Minnesota in *Rodgers v. Bankers National Bank,* 179 Minn. 197, 229 N.W. 90 (1930), at page 95 of 229 N.W., where a trustee in bankruptcy sought recovery against a bank upon similar facts:

> "This is not a case to impress a trust on funds in possession of the bank. The funds are gone. This action seeks to impose a personal liability upon the bank because of an alleged violation of its duty."

*Rodgers v. Bankers National Bank, supra,* contains an able and exhaustive discussion of the very same question involved in the present case. The Minnesota court

reached a conclusion directly contrary to that of the Circuit Court of Appeals for the Fourth Circuit, and absolved the defendant bank of liability for the bankruptcy funds deposited with it.

For the foregoing reasons, it is respectfully submitted that the writ of certiorari herein prayed for to the judgment of the Circuit Court of Appeals for the Fourth Circuit should be granted.

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## APPENDIX.

*Section 47 of the Bankruptcy Act, 11 USCA 75,* relating to the duties of Trustees in Bankruptcy, is as follows:

"(a) Trustees shall (1) collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estates as expeditiously as is compatible with the best interests of the parties in interest; (2) deposit all money received by them in designated depositories; (3) account for and pay over to the estates under their control all interest received by them upon funds belonging to such estates; (4) disburse money only by check or draft of such depositories; (5) keep records and accounts showing all amounts and items of property received and from what sources, all amounts expended and for what purposes and all items of property disposed of; (6) set apart the bankrupts' exemptions allowed by law, if claimed, and report the items and estimated value thereof to the courts as soon as practicable after their appointment; (7) examine the bankrupts (a) at the first meetings of creditors or at other meetings specially fixed for that purpose, unless they shall already have been fully examined by the referees, receivers, or creditors, and (b) upon the hearing of objections, if any, to their discharges, unless otherwise ordered by the court; (8) examine all proofs of claim and object to the allowance of such claims as may be improper; (9) oppose at the expense of estates the discharges of bankrupts when they deem it advisable to do so; (10) furnish such

information concerning the estates of which they are trustees and their administration as may be requested by parties in interest; (11) pay dividends within ten days after they are declared by the referees; (12) report to the courts in writing the condition of the estates, the amounts of money on hand, and such other details as may be required by the courts, within the first month after their appointment and every two months thereafter, unless otherwise ordered by the courts; (13) make final reports and file final accounts with the courts fifteen days before the days fixed for the final meetings of the creditors; and (14) lay before the final meetings of the creditors detailed statements of the administration of the estates.

(b) Whenever three trustees have been appointed for an estate, the concurrence of at least two of them shall be necessary to the validity of their every act concerning the administration of the estate.

(c) The trustee shall, within ten days after his qualification, record a certified copy of the order approving his bond in the office where conveyances of real estate are recorded in every county where the bankrupt owns real property or an interest therein, not exempt from execution, and pay the fee for such filing. He shall receive a compensation of 50 cents for each copy so filed which, together with the filing fee, shall be paid out of the estate of the bankrupt as a part of the expenses of administration. * * *"

(10)

# Supreme Court of the United States

**OCTOBER TERM, 1943.**

**No. 964.**

FIRST NATIONAL BANK IN WEST UNION, WEST VIRGINIA, a Corporation,

*Petitioner,*

—against—

AMERICAN SURETY COMPANY OF NEW YORK, a Corporation,

*Respondent.*

## BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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THE COURT PRESS, N. Y. C.

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## BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

### The Question Presented.

The interrogatory as stated in the Petition (3) contains so many inaccuracies and omissions that it is impossible fairly to apprise this Court of the issue, further review of which is sought, unless the question is reframed. Paraphrasing the opening sentences of the unanimous opinion of the Circuit Court of Appeals (R. 324), the question may be more fully and precisely stated as follows:

> *Is a bank liable for the loss of funds of a bankrupt estate misappropriated by a trustee in bankruptcy where, although it was not a designated depository of bankruptcy funds, the bank allowed the trustee to deposit in his individual account certain checks belonging to the bankrupt estate and to withdraw the fund so created by checks given (by himself and his wife) for personal purposes?*

It is, therefore, a distorted picture (none the less gross because unwitting) of the controversy, presented and de-

cided below, which is outlined by the Petitioner, particularly in the concluding portion thereof in which it is gratuitously assumed that "the bank admittedly had no knowledge of any misapplication or intended misapplication of the funds by the Trustee, received no benefit from the transaction, and was not conscious of any impropriety in accepting such deposit".

Subsidiary to the principal issue, there were involved in the litigation below, certain preliminary matters the disposition of which was necessary to the decision of the ultimate question. These were briefed and argued *in extenso* and, as presented by this Respondent in its brief to the Circuit Court of Appeals (at pp. 4 and 5) included the following:

1. Should the defendant bank (not being a designated depository for bankruptcy funds) have permitted the trustee to deposit checks, payable to him as trustee in bankruptcy, to his personal account therein?

2. Did the defendant bank have actual or constructive knowledge or notice of the trust character of the aforesaid funds so deposited?

3. Should the defendant bank have thereafter permitted the trustee and his wife to withdraw such funds by personal checks drawn in payment of their personal obligations?

4. Did the defendant bank have actual or constructive knowledge or notice that such funds were being misappropriated?

5. Was the defendant bank entitled to apply the funds of the bankrupt estate in its hands to reimburse itself for the sums which it paid out to the trustee individually or on checks drawn by the trustee and his wife individually for

individual purposes at a time when the trustee had no individual funds of his own in the bank?

6. Was there, in consequence, a misappropriation of such trust funds by the defendant bank, or a misappropriation to which it was a party?

To paraphrase the issue as stated later by the Circuit Court of Appeals, the principal question might be formulated as follows (R. 330-331):

> *Is not a bank (not being a designated depository) accountable as a constructive trustee when it accepts from a trustee in bankruptcy (who by statute and General Order is prohibited from depositing bankruptcy funds therein) funds of the bankruptcy estate with express notice of their bankruptcy trust character and of the trustee's breach of legal duty in so depositing such funds, thereby knowingly assisting in the trustee's breach of his fiduciary duty, and credits such funds to his personal accounts in which there are no other funds and permits him to withdraw such funds by his personal check without countersignature by judge or referee in bankruptcy?*

Contrary to the unwarranted assumption that certain facts and inferences from facts favorable to the Petitioner were admitted, the record shows that the circumstantial as well as direct evidence points to the existence of "knowing assistance" on the part of the Petitioner in the perpetration of the misappropriation. From this factual background and not alone from the form of the deposit did the Court below draw its conclusion that the bank was liable. Thus, Parker, *C. J.*, wrote (R. 325):

> "At the time of this deposit, the trustee had no balance whatever to his credit in his account with the bank and had not such balance for ten days or more. The deposit was not an ordinary one, but was four times as large as any that had theretofore been made in that account and stood out in sharp contrast with the other deposits, which were for very much smaller

sums, only two other deposits in the history of the account being for as much as $1,000.00. On the day following the deposit, he drew a check against it in the sum of $701.00 in repayment of another fund which he had embezzled, and the remainder of the deposit was gradually checked out by checks drawn against it by the trustee and his wife until on December 6, 1937 the credit balance was entirely exhausted. During this period only one deposit had been made in the account, a deposit of $33.80 on September 10th. The cashier of the bank had served in a bank designated as a bankruptcy depository and was familiar with the limitations applying to the deposit and withdrawal of bankruptcy funds."

And again the learned Judge wrote (R. 327-328):

"* * * When to the fact that the checks were payable to the trustee in bankruptcy in his capacity as trustee is added the fact that the deposit was four times as great as any other made by the trustee in the entire history of his account, that the account had been exhausted at the time of the deposit, and that the bank was a small one with only four employees in a rural community, it is impossible to escape the conclusion that the bank had knowledge as well as notice that the deposit consisted of bankruptcy funds, which the trustee had no right to deposit except in an authorized depository. This is virtually admitted by the cashier in the following passage occurring in his testimony * * *."

It thus appears that the Petitioner has been less than careful in dealing with the facts and with the record when in the question presented to this Court it gratuitously assumes that "the bank admittedly * * * was not conscious of any impropriety in accepting such deposit". Other inaccuracies might also be cited. And while the Petitioner argues that the Circuit Court of Appeals based its reversal on a "very narrow ground" (Petition 11) it fails to refer to the other grounds, independent as well as supplemental, with which the record is replete and upon which it might have predicated its disaffirmance. In this,

and in their over-simplification of the issues in general, the Petitioner's counsel are doubtlessly moved by their desire to persuade this Court to take up a case which is barren of novelty and devoid of "national significance and importance". If the facts are examined and not taken for granted, they will be found adequate to support the decision of the Circuit Court of Appeals; and if the decision is interpreted in the light of those facts, it will be found to be in accordance with the law and consonant with sound banking practice.

## Statement of the Matter Involved.

The Petitioner's account (Petition 4-13) under the above heading requires a supplementary statement of certain facts and considerations which have not been touched upon therein but which are material and relevant in this case and themselves support the decision below.

As pointed out by the Petitioner, the trustee endorsed the checks deposited by him in his capacity as trustee in bankruptcy. *He did not endorse them individually.* This is important because it constitutes one of the material points of distinction from *Rodgers* v. *Bankers National Bank*, 179 Minn. 197, 229 N. W. 90, relied upon by the Petitioner (Petition 15-16, 20, 35-36). In the *Rodgers* case, checks were endorsed by the payee-trustee, as such, and then by him individually and deposited in his individual account. From this it might be argued that the trustee obtained title to the funds as an individual and that the customary relation of debtor and creditor between him and the bank was then created. In the instant case, however, assuming such a transmutation of legal relationship were possible by the interposition of an individual endorsement before deposit, no such operation occurred here and the trust moneys remained trust moneys. Hence, it follows that when the Petitioner honored the

individual checks of Ware (the trustee) at a time when he had no money of his own in the bank, the latter was extending personal credit or allowing an overdraft. Ware having failed to reimburse the bank for the advancement, it follows that the Petitioner had no right to seize the trust funds for the purpose of recouping its loss, thereby deriving a benefit.

> *United States Fidelity & Guaranty Co.* v. *Hood*, 122 W. Va. 157.

In the disbursement of the funds of the bankrupt estate the bank was as willing and as knowledgeable a functionary as when it received the deposit in the first place contrary to law. Just as it has been shown and testified to that the bank lent itself to Ware's machinations by taking the deposit in the first instance only because it trusted Ware, so only because it had faith in Ware's fundamental honesty *or* because it felt he could make good any loss the bank might suffer in consequence of the joint venture, did the Petitioner honor his checks regardless of to whom they were drawn and for what purpose. This the bank would not have done, as the cashier said, for anyone but Ware or a person occupying a similar status (R. 142). Thus, the bank had guilty knowledge. It need not have taken any chance at all because not being a designated depository it should not have accepted the deposit at the outset. And if it could have lawfully accepted bankruptcy funds, it should not have honored the trustee's checks without the counter-signature called for by a beneficent law the purpose of which was to protect the bankrupt's creditors and the bank alike.

In paying out the money as in receiving it, the bank acted at a peril known to it and took chances the consequences of which it was aware. Otherwise, there would have been no point in the bank employees' repeated dec-

larations of the faith they had in Ware at the time they dealt with him (R. 142, 144).

The immunity from inquiry enjoyed by Ware apparently extended to his wife who not only drew against trust funds deposited by her husband but did so without the requirement of any power of attorney, an elementary precaution called for by the most casual and trusting of banking institutions (R. 133, 153, 181).

The important and legally significant fact is that the Petitioner knew that not a dollar of the trust moneys which it freely paid out until the fund was exhausted was employed for aught than the trustee's personal purposes or those of his wife (R. 137, 138, 140-142, 185-186).

Detailed examination of the checks themselves (R. 266, 304) serves but to confirm the testimony of the Petitioner's cashier that they bore no marks indicating that they were employed for other than Ware's benefit and that of his wife. From this the bank's employees correctly assumed, as they stated, that the money was being used for personal purposes. A trustee in bankruptcy ordinarily draws checks only to pay administrative expenses and claims of creditors. No checks of this character, it is conceded, were drawn upon the account in question by Ware (R. 157). Moreover, the checks on their face and the manner of their handling by Ware and his wife clearly show now, and clearly indicated to the Petitioner then, that the proceeds were not used and were never intended to be used for fiduciary purposes but were used to pay the obligations of Ware and his wife or went into their pockets. It would be fruitless and serve no purpose here to consider and analyze each of the checks so drawn in order to show what the Petitioner's witnesses have admitted on the trial by way of supplementing and implementing the stipulation of facts (R. 58-68) which alone is sufficient to justify judgment against the bank. But it is nevertheless interesting and not a little shocking to run through the vouchers and observe the manner in which Ware, with the bank's knowledge and assist-

ance, gnawed, pecked and nibbled at the corpus of the trust until nothing but an empty shell was left for the creditors. The quantity of checks, the smallness of many of the amounts, the number payable to cash, the repeated use of the same payee and the names and businesses of the several payees, all well known to everybody in that small community, are as informative and significant to the stranger as they were to the bank on the question of how the money was used. The mute testimony of the books and documents recording this transaction or series of transactions from beginning to end is as revealing as the express stipulation of counsel and the declarations of the witnesses and as eloquently cried aloud for correction not only in the interest of the bankrupt's creditors but of the bank's depositors whose interests were jeopardized by a practice which, it is understood, has now been discontinued by the Petitioner.

Even if the Petitioner had not known throughout the course of these transactions just what was happening there were numerous signs right from the outset pointing to Ware's misappropriations and at least technical faithlessness to the trust which he shared with the bank. For example—a trustee performing his fiduciary duties does not use the local drugstore as a place to cash numerous checks—he does not draw a great many checks to the order of "cash" ranging in sums from one dollar up (R. 304-306)—he does not throw open his account to the use and for the accommodation of his wife. Since the bank knew all this as a joint participant in Ware's activities, the function of inquiry meant little, because even if exercised, it would have added virtually nothing to that of which the Petitioner was already aware.

Nor was it exactly a matter of the bank's closing its eyes to a state of affairs which would have put another institution on guard, because the scene was one which was regarded by this Petitioner with the utmost complacency and even satisfaction. In other words, it was a matter of absolute indifference to the bank what Ware

did with the money, whether he paid his own creditors, whether he used it for pocket money or whether he put it at his wife's disposal. All this is in the record. It stands uncontroverted. The impeachment of irregularity is admitted. In fact, this is the bank's own story of how and where the money went (R. 139-141).

All of the foregoing would be entirely incredible and incapable of rationalization were it not for the fact that the bank itself, by a spurious plea of confession and avoidance, offered an explanation and an excuse, not a good excuse or even a satisfactory excuse and certainly not a legal excuse, namely, that Ware was a responsible man and a prominent and prosperous lawyer (R. 172, 193, 195).

It is respectfully submitted that this might have been sound banking judgment and justification for extending a line of credit to Ware personally—which is what the bank in effect did—but the bank had no right, on Ware's failure, to reimburse itself from the funds of the bankruptcy estate upon which it had laid illegal hands with the help of Ware in the first instance. Nor, to put it another way, did the bank have any right to disburse the estate moneys regardless—on the strength of Ware's personal ability to make good out of his own resources if the bank should be called to account—as it now is. Nor, to put it still another way, did the bank have a right to accommodate what seemed to be a favored and valued customer on any basis other than at its own risk and assumption of loss, if it turned out, as it did, that the bank had misplaced its trust.

## Grounds Relied Upon for Allowance of Writ of Certiorari.

The Petitioner seems to present a feigned issue between the West Virginia law as applied by the District Court and the Federal law as applied by the Circuit Court of Appeals (Petition 18).

To be sure, the District Court did say that the Petitioner's liability must be tested by the law of West Virginia (R. 84). But it did not say that the law of West Virginia was contrary to the Federal law or to the general rule.

And the Circuit Court of Appeals did say (R. 331): "In determining the liability of a bank for a deposit of bankruptcy funds made in violation of the terms of the bankruptcy act, however, we do not understand that we are bound by decisions of the local courts; for the question involved is one of federal rather than of local law" (citing cases). But that Court also said (R. 331):

> "We find nothing in the law of West Virginia opposed to the rule which imposes liability as constructive trustee upon a bank which knowingly accepts a deposit that the depositor is forbidden by law to make with it. On the contrary, the general rule seems well settled in West Virginia that one who receives a trust fund with notice that he is not entitled to receive it, is liable to account therefor. * * * We do not understand that under the law of West Virginia a bank which has thus assisted in a misappropriation of funds can escape liability merely because it did not know that the trustee intended to steal them. If, therefore, we were bound by the West Virginia decisions in determining the liability of the bank, we would entertain no doubt as to its liability for the deposit."

Upon the facts as stated hereinbefore, judgment should go against the Petitioner in any court. The Petitioner has not shown in what forum or under what judicial system any different rule would apply. It is unable to bring this case within the purview of any part of Section 5 of Rule 38 of this Court.

## I.

**The Circuit Court of Appeals was correct in holding that the Federal law governs.**

This point is fully and completely dealt with in the opinion below (R. 331-333) wherein Judge Parker wrote:

> "In determining the liability of a bank for a deposit of bankruptcy funds made in violation of the terms of the bankruptcy act, however, we do not understand that we are bound by decisions of the local courts; for the question involved is one of federal rather than of local law. *Clearfield Trust Co.* v. *United States* 318 U. S. 363; *Sola Electric Co.* v. *Jefferson Electric Co.* 317 U. S. 173; *D'Oench, Duhme & Co.* v. *F. D. I. C.* 315 U. S. 447; *Deitrick* v. *Greaney* 309 U. S. 190; *Barnes Coal Corp.* v. *Retail Coal Merchants Ass'n* 4 Cir. 128 F 2d 645; *Cannon* v. *Dixon* 4 Cir. 115 F. 2d 913.
>
> "Directly in point, we think, is the very recent decision of the Supreme Court in *Clearfield Trust Co.* v. *United States, supra.* In that case the question involved was the liability of a bank upon its indorsement of a government check which it had taken upon the forged indorsement of the name of the payee. The defense was that the bank was discharged of liability under local law because of delay of the United States in giving notice of the forgery. In holding the bank liable, the Supreme Court said:
>
> > 'We agree with the Circuit Court of Appeals that the rule of *Erie R. Co.* v. *Tompkins,* 304 U. S. 64, does not apply to this action. The rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law. When the United States disburses its funds or pays its debts, it is exercising a constitutional function or power. This check was issued for services performed under the Federal Emergency Relief Act of 1935, 49 Stat. 115. The authority to issue the check had its origin in the Constitution and the statutes of the United States and was in no way dependent on the laws of Pennsylvania or of any other state. Cf. *Board of Commissioners*

> v. *United States* 308 U. S. 343; *Royal Indemnity Co.* v. *United States* 313 U. S. 289. The duties imposed upon the United States and the rights acquired by it as a result of the issuance find their roots in the same federal sources. Cf. *Deitrick* v. *Greaney* 309 U. S. 190; *D'Oench, Duhme & Co.* v. *Federal Deposit Ins. Corp.* 315 U. S. 447. In absence of an applicable Act of Congress it is for the federal courts to fashion the governing rule of law according to their own standards.'
>
> "The control of bankruptcy funds, like the right of the federal government to issue checks, is based upon the Constitution and laws of the United States. The rights and liabilities with respect to the handling of such funds 'find their roots in the same federal sources'; and 'in the absence of an applicable Act of Congress it is for the federal courts to fashion the governing rule of law according to their own standards'. If the local law is not to be looked to for the purpose of determining the extent of a bank's liability upon its indorsement of a check issued under federal law, there is no reason why it should be determinative of the bank's liability with respect to a deposit of funds held by a trustee in bankruptcy for administration under that law. In both cases the bank is dealing with a subject matter controlled by federal law; and in both cases there is the same reason why federal and not local law should determine its rights and obligations."

After discussing *Sola Electric Co.* v. *Jefferson Electric Co., supra,* Judge Parker stated:

> "* * * A federal statute here requires the deposit of bankruptcy funds in a designated depository. A deposit elsewhere is violative of the statute; and the consequences flowing from such violation would seem clearly to be 'federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted'" (R. 334).

The Court also discussed *Dietrick* v. *Greaney, supra,* and concluded on this point:

> "On like principles it is clear that a 'federal not a

> state question' is involved in the determination of the legal consequences which flow from a bank's accepting a deposit of bankruptcy funds made in contravention of the provisions of the bankruptcy act" (R. 334).

It is noteworthy that the Petitioner under this point has not referred to the discussion of the Court below or the authorities mentioned therein.

## II.

**No conflict exists among the Circuit Courts of Appeals requiring review of the instant case by this Court.**

The Petitioner has sought to put the decision below in conflict with the holdings in *In re Bogena & Williams* (Seventh Cir.), 76 F. (2d) 950, and *Irving Trust Company* v. *United States* (Sixth Cir.), 83 F. (2) 20 (Petition 24-31). These determinations were duly noted by the Circuit Court of Appeals but it "did not think that they should control our decision here" (R. 329). While some disagreement was expressed with the reasoning in the cases cited, the situations were also distinguishable on their facts. As stated by the Circuit Court of Appeals (R. 329):

> "* * * They were concerned, not with the liability of the bank to the bankrupt estate, but with the right of the estate to preferential treatment in distribution of assets of banks which had become insolvent, and the effect of the decisions was to place the claims of the bankrupt estates on an equal basis with the other depositors * * *."

Each case, we respectfully reiterate, should be viewed in the light of its particular facts and surrounding circumstances. What appear to be conflicts in principle dissolve. *In re Potell*, 53 F. (2d) 877, is particularly pertinent. In this case a bankruptcy receiver deposited estate funds in a bank not designated as a depository. It

was held that the bank must return the money to the bankruptcy receiver. Speaking of Section 61 of the Bankruptcy Act of July 1, 1898 and General Order in Bankruptcy No. 29 the Court in that case said (p. 879):

> "That Congress considered these provisions essential to the proper and safe custody of the funds of a bankrupt estate is evident not only from the law as expressed but from the nature of the deposits. The effect thereof is certainly to 'prohibit' the depositing and reception of such funds in and by unauthorized depositories.
>
> "It is plain therefore, that the said receiver in bankruptcy had no right to deposit money of the bankrupt estate contrary to the above provisions of the laws and rules. That whether or not a bank was a designated depository was easily ascertained and a public record. That the officers of the bank knew or should have known that it was not a designated depository. They knew or should have known that they had not even presented nor had filed the bond without which no designation would be made.
>
> "Thus, we came to the question: In whom was the title to this money so unlawfully deposited? The title was not in the bankrupt, for he had been duly adjudicated. It was concededly a part of the bankrupt's estate applicable to the payment of creditors. It was not in the receiver of bankruptcy for he is a mere custodian of such estate. There was no trustee and is none today. This money pending the presence of a qualified trustee, was in the custody of the Court. (Cases cited.)
>
> "Such funds in the temporary possession of a receiver in bankruptcy and held by him in trust as such custodian, and a bank unlawfully receiving such money with full knowledge of the peculiar character of the deposit and in opening a prohibited account with such receiver received it impressed with such trust. The principle in *Allen* v. *United St tes,* 285 F. 678 (C. C. A. 1st), seems applicable."

## III.

**The trust character of the funds received by the Petitioner and not their "public" or "private" status is controlling on the question of the depository's responsibility.**

To sustain a contrary view the Petitioner relies upon *Willoughby* v. *Howard*, 302 U. S. 405 (Petition 31). But, as stated by Mr. Justice Brandeis in his opinion the only question in that case was the following (p. 446):

> "The question for decision is whether a trustee (or receiver) in bankruptcy and the surety on his official bond can be held liable for the loss resulting from the insolvency of the bank in which the estate's funds were deposited, if it was one of the depositories designated by the court under 11 U. S. C. A. §101."

This Court held that the Bankruptcy Act did not in terms relieve the trustee of the common law duty to exercise care in the custody of funds; that the fact that the freedom of choice of the fiduciary is limited by statute does not relieve the trustee of the duty of care and prudence within the field left to his discretion; and that the issue of exercising care in making and maintaining deposits, even if made in a designated depository, should have been submitted to the jury, particularly in view of the personal loans made by the depository to the trustee. In the course of its opinion this Court did point out that the funds of bankrupt estate are private funds as distinguished from federal public funds for which Congress has provided a depository system by which the moneys, as soon as deposited, are in effect in the Treasury of the United States. In this respect, of course, "the provisions in the Bankruptcy Act concerning the appointment of depositories and the deposits to be made by trustees are of a very different character" (*idem*, pp. 453-454). But as the Court below stated (R. 329) "this is a distinc-

tion without a difference". Moreover, the Petitioner not having been a designated depository, it is rather idle to speculate on whether bankruptcy funds which were improperly accepted for deposit therein were "public" or "private" funds since in either case the Petitioner held and dealt with them at its peril.

The case of *Maryland Casualty Company* v. *Central Trust Company* (New York), 265 App. Div. 416, cited by the Petitioner (Petition 34), is likewise not helpful in the present discussion. There, the Appellate Division (Fourth Department) of the New York Supreme Court merely held (one Justice dissenting) that in a suit by the surety on the trustee's bond based upon the wrongful payment by the defendant bank of checks drawn against funds of a bankrupt estate deposited therewith, where the referee's name had been forged by the trustee in bankruptcy, the pleading by the bank of the usual defenses of due care, and the like, should not be stricken out "unless some other reasons appear to prevent the use of such defenses" (p. 421). Unlike the Petitioner herein, the bank again was a duly designated depository of bankruptcy funds.

Both the District Court (R. 88) and the Petitioner (Petition 16) quote the following statement from the Respondent's brief in the District Court:

> "It is not contended by the plaintiff that there is anything in the Federal statutes, rules and orders which, without more, imposes an absolute liability in the premises upon the defendant * * *."

But neither the District Court nor the Petitioner included in its quotation the sentence following the foregoing which read (Plaintiff's Brief, District Court, 42):

> "* * * By the same token it is highly paradoxical for the defendant to urge that because it was not a designated depository it is exculpated from liability for acts for which it would ordinarily be responsible."

We were not aware that our discussion of this point in the District Court was shrouded in such subtleties that we failed to reach the understanding of that court. Whether or not the Petitioner was a designated depository, and it is conceded that it was not, and whether or not the bank had authority to receive the moneys of bankrupt estates, and it is conceded that it did not, the fact of the matter is that the Petitioner in this instance did receive such moneys and did receive them with express notice and actual knowledge of their trust character which appeared on their face. Whether or not the Petitioner was a statutory depository and whether or not, because of its non-official character, it was absolved from observance of certain administrative rules, the bank was still subject to the ordinary rules of law pertaining to the handling of trust moneys. It is the height of absurdity to contend that because a bank received knowingly and wrongfully, if not unlawfully, funds which it was not eligible to receive and which the trustee was prohibited from depositing therein, it could thereafter handle such money free from all the restraints and restrictions imposed by the familiar rules of common and statutory law in such cases applicable. *Seaboard Surety Co.* v. *State Savings Bank of Ann Arbor* (Mich. Sup. Ct.), 11 N. W. (2d) 321.

We have hitherto adverted to the proposition that the case of *Rodgers* v. *Bankers' National Bank*, 179 Minn. 197, 229 N. W. 90, frequently referred to in the Petition (15, 20, 35), is distinguishable in point of fact from the instant case, in that, among other things, the checks in the *Rodgers* case were endorsed individually by the trustee as well as in his representative or fiduciary capacity. In the case at bar, the trustee did not endorse the checks in an individual capacity. Hence, they came into the bank impressed with the trust clearly labeled on the face and obverse side of each of the eight instruments. The Circuit Court of Appeals has dealt adequately with the

points raised in the *Rodgers* case and the following excerpt from its opinion should, it is submitted, be left as the final word on the subject (R. 330-331):

> "Defendant points to the statement in *Rodgers* v. *National Bank, supra*, to the effect that 'the provisions of the bankruptcy act and the general order mentioned were not meant to regulate the conduct of a bank which is not a designated depository'. This is stating the rule too broadly. It is true, of course, that the provisions of the bankruptcy act and of the general orders in bankruptcy do not apply to a bank which is not a designated depository; but this does not mean that such bank may receive with notice funds which are being deposited in violation of law without taking same as a constructive trustee in accordance with the well settled rule which we have discussed. The statute and general order do not apply to the bank, but they do impose a legal duty upon the trustee in bankruptcy not to deposit the funds therein; and the liability of the bank arises when it receives the funds with notice that they are trust funds and that the trustee is making the deposit in breach of the duty imposed upon him by law. A bank which thus knowingly assists a trustee in the violation of his trust, by allowing him to deposit in his personal account and check out with his personal check funds which he has the right to deposit only in a bonded depository and check out only with a check countersigned by the judge or referee, has no ground to complain when it is held to the liability of a constructive trustee of such funds."

When complaint is made that the rule applied works a hardship on the Petitioner it should be remembered that no extraordinary burden of supervision is placed upon banks handling the estates of bankrupts. Indeed, this burden is substantially assumed by the courts because General Order in Bankruptcy 29 specifically requires the countersignature of a referee in bankruptcy on checks drawn upon bankuptcy funds. To the argument that the Petitioner was not a designated depository the obvious answer is that if such a bank insists upon accepting a prohibited

account it subjects itself to at least the same degree of accountability for supervision, the only difference being that the supervision is unofficial and not judicial but the nature and extent thereof are at least equivalent to that required in the case of other trust estates. As the Circuit Court of Appeals said (R. 328):

> "* * * The safeguards so carefully erected for protecting the deposit and withdrawal of bankruptcy funds would mean little if trustees in bankruptcy were at liberty to disregard them whenever they saw fit to do so, and if banks not authorized as depositories might accept deposits of bankruptcy funds knowing them to be such, credit them to the personal accounts of the trustees and allow them to be withdrawn by the personal checks of the trustees countersigned by no one."

## IV.

**By failing fully and fairly to apprise this Court of the issues tried and argued below, the Petition attempts to make it appear, contrary to the record, that the judgment is supportable only on a favorable determination of the single issue selected for discussion.**

Mention has already been made at the outset that the "question presented" as the basis of the petition for review contains assumptions of admissions allegedly made which are wholly unwarranted. Because the matter goes to the substance upon which the Petition is allowed or denied, we are moved again to advert to the point because of the following statement at the foot of page 11 of the Petition:

> "*Conceding* that the Bank had no knowledge whatsoever of any misapplication of funds by the Trustee, the Court of Appeals based its reversal as to the $4,050.00 item upon this very narrow ground; that * * *." (Emphasis supplied.)

and by the following statement at page 33 of the Petition:

> "* * * The rule of absolute liability applied by the Court of Appeals to Petitioner, in the *admitted* absence of any knowledge on Petitioner's part that the Trustee was misappropriating bankruptcy funds, seems unduly harsh * * *." (Emphasis supplied.)

No such "concession" was made by the Circuit Court of Appeals in respect of the $4,050 item represented by deposited checks. What the Court below said on this point was to summarize the contentions of the respective parties. Thus (R. 335):

> "* * * It is *argued* that the bank should have known from the nature of the checks drawn against the trustee's account that he was misappropriating the funds there deposited; but the officials of the bank *deny* that they knew of the misappropriation or that they paid any attention to the checks drawn by the trustee, assuming that they were properly drawn * * *." (Emphasis supplied.)

In the succeeding sentence of the opinion, which is set out on page 11 of the Petition, the Court speaks of finding no evidence of knowledge on the part of the bank but it is there referring to the item of $793.62 representing checks cashed, not deposited, which matter is not under discussion.

Nor is there any "admitted" absence of knowledge on the Petitioner's part. It must now sufficiently appear to this Court from the record and from this discussion that, beginning with the pleadings and extending throughout the proceedings in the courts below, the issue of the presence or absence of knowledge or notice, actual or constructive, direct or inferential, with respect to *both* the receipt and the disbursement of the funds was the subject of earnest and lengthy argumentation by both parties and of consideration by both courts.

Among other things, it was the contention below of the Respondent, as it is now, that, under the circumstances,

the bank was liable not only because it accepted the deposit but because it permitted its withdrawal in the manner stated, and in support of this proposition references were made to many authorities including the A. L. I. Restatement of the Law of Trusts, particularly Sections 297 and 324. It was also the Respondent's contention then, as it is now, that upon the evidence before the District Court judgment for the Respondent could be sustained upon a selection of legal theories, where a situation involves the responsibility of those whose hands are put upon moneys and whose minds are touched with knowledge of the purpose thereof but whose eyes are averted when the malefactions are committed.

Because of the generality of the rules cited by the Courts below and by opposing counsel and, indeed, by ourselves, it is our submission that while adherence must be had to their enveloping authority, each case must in final analysis be decided on its own circumstances. And this, it is further submitted, is the principal reason why neither justice to the individual nor the public interest will be served by review of the case by this Court.

**For the foregoing reasons, it is respectfully submitted that the writ of certiorari prayed for in the Petition to the judgment of the Circuit Court of Appeals for the Fourth Circuit should be denied.**

Respectfully submitted,

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